International Journal of Development and Sustainability
ISSN: 2186-8662 – www.isdsnet.com/ijds
Volume 3 Number 10 (2014): Pages 2037-2048
ISDS Article ID: IJDS14101401

Climate finance paradox: Should Indonesia accept climate change program loan?

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Abstract

This paper addresses the fairness aspect of loan for Indonesia in relation with climate change mitigation and adaptation programs. It examines the proposals of the Climate Change Program Loan (CCPL) from various donors and development partners whether or not Indonesia deserves to accept CCPL from developed countries. The research uses a qualitative approach, specifically an archival analysis strategy to critically analyse global and domestic climate finance policy frameworks. It mainly uses three major documents of international climate change negotiations – the Convention, the Copenhagen Accord, and the Kyoto Protocol – to understand how the financial burden should fall in principle. It further discusses some policy implications whether or not Indonesia should receive Climate Change Program Loan. The results show that the developed countries should assist Indonesia to finance its climate change mitigation and adaptation program in the form of grants, not loans. The research suggests that Indonesia should stop the Climate Change Program Loan and should not receive any kinds of the loan related with climate change from developed countries anymore.

Keywords: Climate Change; Program Loan; Grants; Finance

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Cite this article as: Rakhmindyarto (2014), "Climate finance paradox: Should Indonesia accept climate change program loan?", *International Journal of Development and Sustainability*, Vol. 3 No. 10, pp. 2037-2048.

1. Introduction

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It has been widely believed that now climate change is a global threat to all of us because of the rise of greenhouse gases (GHGs) in the atmosphere. The results of the study clearly show that the concentration of the GHGs in the atmosphere is constantly increasing. Spratt (2009, p.4) states that "In mid-2008 the degree of concentration equivalent to 420 ppm of CO2 and GHG emissions increased by 3% each year".

The adverse impacts of climate change have spread over the world and entered into the system of life. Unfortunately, the most affected are the poorest countries in the world and the poorest people in these countries. This miserable fact is coupled with the reality that they do not play a role or have small role to cause climate change. Climate change we are experiencing now is the result of the cumulative impact of industrialization activities by developed countries. Therefore, they are the countries most responsible and bear the burdens to overcome the climate change.

Although it can be said that developed countries are the causes of climate change, we can not blame away without doing anything. Collective actions of mitigation and adaptation to climate change are absolute necessity. In this regard, the government of Indonesia has sought to implement GHG emission reduction commitments through Presidential Decree No. 61 of 2011 regarding National Action Plan of GHG Emission Reduction. We hope that this action plan can trigger a massive movement in all parts of Indonesia to jointly deal with and protect ourselves and our country from the effects of climate change.

One of the biggest challenges in conducting mitigation actions and adaptation to climate change is how to finance these actions. Ministry of Finance (2012, pp.xxxv) estimates that the total indicative costs of climate change mitigation action in Indonesia are expected to be around Rp100-140 trillion/year for forestry, peat land, energy, and transportation. The financial sources come from national budget, private sectors, and also from international funds.

Climate finance is not only seen from the domestic perspective, but also from the standpoint of global community. Developed countries have pledged to give the international climate change financing of 100 billion dollars per year by 2020. The Funds are intended to the reduction of GHG emissions through mitigation actions and adaptation to climate change in developing countries. Pittel and Rubbelke (2011, p. 2) states that "The vision for long term cooperative action with respect to global warming that was stipulated in Cancun is explicitly put on the basis of equity and of accordance with common but differentiated responsibilities and respective capabilities (UNFCCC 2011)". However, until now there is no unanimous agreement on how the actual amount to be provided by developed countries, how to channel it, how to set up the criteria for the recipient countries, and what the principles of good governance or finance business process itself.

As a country committed to reducing carbon emissions by 41 % with foreign aid, Indonesia has been trying to seek sources of funding from abroad to finance its climate change mitigation and adaptation programs. Sources of funding sought by the government could be in the form of loans and grants. Loans obtained by the government for activities related to climate change called the Climate Change Development Policy Loan (CCDPL) or commonly called the Climate Change Program Loan (CCPL). Within the CCPL mechanism, donors and the government development partners jointly develop an action plan for climate change policy or matrix based on National Action Plan *(Rencana Aksi Nasional)* and jointly monitor progress in implementation.

Based on the results obtained from the implementation matrix, donors can provide additional financial support if requested and needed by the government. The Steering Committee (SC) is established to monitor the progress of policy measures in the policy matrix loan program and to discuss issues that remain unresolved in the implementation. There is a Joint Monitoring Meeting held at least twice a year which allows donors and the Government to monitor and discuss the progress of the action plan.

The CCPL has become a climate finance paradox in that it has created more burdensome responsibility for Indonesia to fight climate change. To combat climate change, Indonesia as developing country needs financial assistance from developed countries, not loans which have to be returned.

This paper addresses the fairness aspect of CCPL to finance climate change mitigation and adaptation programs in Indonesia. It aims to provide a critical analysis whether Indonesia deserves to receive loan to finance its climate change mitigation and adaptation programs. This is due to the fact that global climate change problems have been mostly caused by industrialization process in the developed countries, and it is the developed countries responsibility to assist developing countries including Indonesia in addressing climate change adverse effects. However, the assistance from the developed countries to help developing countries in tackling climate change effects often give more burdens because their financial assistance are in the form of loans. The developed countries should provide financial assistance to developing countries in the form of grants as their compensation from causing global climate change. The paper is divided into four sections. First, the introduction section outlines the background of the paper. The second part is the review of literatures. The next section is the methodology employed in the paper. Then it is followed by the section of results and discussions which provides the main findings of the paper. The paper is concluded by research recommendations which are useful for policy makers to revisit current policy frameworks.

2. Review of literatures

Stern (2007, p. viii) states that “The climate change is the greatest market failure the world has ever seen”. In this context, the climate change causes damage to society created by the greenhouse gas emissions. The magnitude of the costs imposed by climate change is so large that, if left unaddressed, it will lead to catastrophic outcome. The climate change mitigation basically aims to address this market failure. The Stern Review shows both the global advantage of climate change mitigation action and the high cost if we do nothing.

In its third assessment report, the IPCC (Intergovernmental Panel on Climate Change) has forewarned the international community regarding the inevitable impingements of climate change in the next ten to twenty years. Huq and Toulmin (2006, p. 2) comments about the report that “It also pointed out that impacts would not be uniform across the globe, but that poor countries and poor communities in all countries would be vulnerable and would need assistance to adapt”. Further to this, Spratt (2009, p. 4) states that “The impacts will be felt hardest by the least able to cope: the poorest countries in the world and the poorest people within these countries”. Spratt (2009, p. 4) adds that “Moreover, the tragic fact is that those who stand to lose most through the effects of climate change have little or no responsibility for creating it: it is the cumulative impact

of industrial activity in the developed countries, therefore, that need to shoulder the burden of dealing with it".

It is scientifically agreed that the process of industrialization has harmfully caused the increase of the greenhouse accumulation in the atmosphere. In their opinion, Huq and Toulmin (2006, p. 1) say that "The rich countries were the countries principally responsible for past emissions and would take action first; the costs of adopting low carbon technology are now recognized as insignificant in comparison to the risks of massive and catastrophic changes if we do nothing; a major challenge now is to find ways to compensate people for the damage that has already been done".

The fact that climate change needs to be addressed universally, it becomes more complicated to reach an economic consensus at international level. Even though the developed countries have agreed to mobilize the climate funds up to USD 100 billion per year by 2020 to fulfill the needs of developing countries, it is still by no means certain where the money comes from, how it will be delivered, and where it will fall.

Brown and Peskett (2011, p. 4) state that "International finance for climate change is high on the agenda of the international climate negotiations, and has become an important barometer for how rich countries shift away from carbon-intensive development to lower carbon development pathways". At the Conference of Parties (COP) 16 in Cancun Mexico in 2010, it was formalized to mobilize USD 100 billion through the Green Climate Fund by 2020.

Climate finance will be a key to tackle climate change. Global collective actions must be taken upon 'common but differentiated responsibilities' basis. Eliasch (2008, p. 83) states that "Any future international climate change framework should be based on three criteria: effectiveness, efficiency, and equity". Eliasch (2008, p. 83) also states that "The framework should be effective to deliver the emissions reductions at the required scale; efficient to minimize the overall cost of achieving the emissions reductions; and equitable to ensure that the benefits of international action are distributed fairly".

The International framework of climate change has been set up by the United Nations Framework Convention on Climate Change (the UNFCCC). The specific aims of the UNFCCC for developed countries are to reduce their greenhouse gas emissions to 1990 levels by 2000. Eliasch (2008, p. 103) states that "The Kyoto Protocol to the UNFCCC, which was agreed in 1997 and entered into force in 1995, sets mandatory emissions reduction or limitation commitments for developed countries for the first commitments period, 2008 to 2012, and sets up a process for negotiating further commitments for subsequent commitment periods". Under the Kyoto Protocol, countries are divided into three categories:

- 1) Annex 1 (OECD countries and economies in transition);
- 2) Annex 2(OECD countries only);
- 3) Non-annex 1 (mostly developing countries).

As developed countries produce the most greenhouse gas emissions in the world, they should bear the greatest responsibilty and should provide financial resources to developing countries, which are most affected by climate change.

Eliasch (2008, p. 108) divides that "There are three mechanisms of financing climate change under the Kyoto Protocol: International Emission Trading, Joint Implementation, and the Clean Development Mechanism, which collectively constitute a prototype international emissions trading framework or carbon market". Under the International Emission trading scheme, the Annex 1 countries can buy carbon credits or allowances from other annex 1 countries. Under Joint Implementation scheme, an Annex 1 country can implement an emission-reduction joint project to another annex 1 country. Under the Clean Development Mechanism, Annex 1 countries can establish project activities that reduces the greenhouse gas emissions in developing countries (non annex countries). In exchange, annex 1 countries can buy the carbon emission credits or certified emission reductions (CERs).

Indonesia, a middle income country and a member of the G20 as well, could play a significant role in reducing global greenhouse emissions. This is due to the fact that Indonesia is one of the largest global greenhouse gas emitters. However, it is important to be noted that the nation has to be equalizing its economic development and emission reduction priorities.

Brown and Peskett (2011) conducts the research with regard to Indonesia climate change finance. Brown and Peskett (2011, p. 5) states that "The paper draws early lessons from Indonesia as a national case study to help inform some of these debates at the international level". The paper concludes that the international finance available for Indonesia has led to the increased number of climate change activities. However, lack of coordination among Indonesian institutions creates some drawbacks which cause the funding has been ineffectively used. Brown and Peskett (2011, p. 32) also states that "The nature of the relationship between north and south could be different from the traditional donor-recipient relationship". It implies that fighting climate change adverse impacts need to be financed on the basis of equal relationship between developed and developing countries rather than donor-recipient partnership.

3. Research methodology

This research uses a qualitative approach, specifically, a desk research techniques. It intends to critically analyse current international diplomacy, protocol, treaties, and policy frameworks around the global and domestic climate change policy settings. In particular, there will be a critical analysis of politics and policy of three major climate change documents: the Convention, the Copenhagen Accord, and the Kyoto Protocol. The data and information used in this research are already available in the public domain, therefore permission to gather information from the data sources may not be necessary.

4. Results and discussion

4.1. National budget reform

During the New Order regime, at least between the fiscal year 1969/1970 and 1998/1999, the National Budget had been established based on balanced budget system *(T account)* and were classified into two large

side, namely revenues and expenditures. The revenue side consisted of domestic revenues and development revenues. Development revenues according to the budget were revenues derived from foreign loans and grants. Development revenues consisted of two components, namely project aids and programs assistance. Programs Assistance were foreign loans and grants in the form of food and non-food as well as loans that could be converted to rupiah. While the project aid were foreign loans or grants used to finance development projects.

Based on those understandings, it can be concluded that the development revenue was the source of state budget funds originating from abroad. Program assistance and project assistance consisted of foreign loans and grants. However, the budgeting system was not transparent to separate between grants and loans. As a result, grants and loans as development revenue components did not seem to have difference because they were placed in one basket. It was not clear which pure grants and which loans required to be payed back. What can be determined from the budget system was that every year the government had to spend some money to pay the foreign debt consisting of principal repayments and interest.

The fiscal year 1999/2000 marked the impetus of fiscal reform era when the government attempted to fix the budget system. Compared with previous years, the 1999/2000 budget was not much changed, using the balanced budget pattern. However, the government was trying to make the budget more transparent. The budget in previous years were considered less transparent and "tricky" especially in development revenue items. In the fiscal year 1999/2000 budget, development revenues changed its name became foreign revenue, so the fiscal year 1999/2000 budget consisted of two sides, domestic revenues and foreign revenues. According to the fiscal year 1999/2000 budget, foreign revenues derived from foreign loans. Foreign loans consisted of two components, namely the program loans and project loans. The program loans were foreign loans in the form of food and non-food loans and convertible loans. The project loans were foreign loans used to finance development projects.

Ariadi (2001, p. 3) states that “From FY 2000 (fiscal year transition before the budget year adjustment to the calendar year), the format of the budget has been prepared in accordance with international standard, the Government Finance Statistics (GFS)”. In Budget GFS format, the system used is deficit spending, i.e. domestic borrowing and foreign loans are a source of funds to close the budget deficit so it is not classified as revenues. This is in contrast to the balanced budget system in which program loans and project loans are included in the state revenues. Also in this new format is explicitly declared the existence of the grant as a source of state revenue. Grants are defined as all state revenues come from donations of domestic private institutions and foreign governments and institutions.

4.2. Government financing strategy

Debt Financing is a way of bridging the deficit commonly done in the state administration in almost all countries in the world. Funding through debt is considered a source of sustainable financing, given the concept of refinancing. However, because it can lead to liability in the future and it will reduce flexibility in the future government to make development policy, it needs to be balanced with a credible, professional, accountable, and transparent debt management. Poor debt management will expose negative impacts on the

economy, among others the failure to pay debt obligations, increasing debt obligations over estimates, decreasing the confidence of investors and creditors, the debt downgrade (sovereign credit rating), the disruption of fiscal sustainability, obstruction of activity due to the insecurity of government financing sources.

In Indonesia, the financing management must be administered by the Minister of Finance as per Law Number 17 of 2003 regarding Financial Management and Law Number 1 of 2004 regarding State Treasury. It has been mandated that the Minister of Finance is obliged to manage the national budget, determine the sources of budget financing, plan and control the use of funds to optimize its functions.

The government has undertaken a deficit strategy in the fiscal policy setting. This has brought the increase of outstanding loans. In addition to cover fiscal deficit, the loans have been used to finance government expenditures such as investments, guarantee, and other financing expenditures.

Table 1. Program Loan and Project Loan (trillion Rp)

2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
6.4	7.2	1.8	5.1	12.3	13.6	19.6	29.6	31.9	29.4	19.2
19.7	11.7	18.6	13.4	14.6	12.5	14.5	14.9	25.7	41.3	36.9

No color: Program Loan Grey: Project Loan
Source: Directorate General of Debt Management, 2012; Ministry of Finance Annual Report, 2012.

4.3. The role of CCPL: Is it the loan for climate change actions?

CCPL is a soft loan given to the Government of Indonesia to support the Government's efforts to develop low-carbon development policies (low carbon development). Brown and Peskett (2011, p. 13) states that "It focuses on mitigation, adaptation and strengthening the institutional and policy framework necessary for a successful response to climate change". Since 2008 CCPL has been jointly funded by Japan (JICA) and France (AFD), and the World Bank recently joined the fray in 2010 . The loans are provided and disbursed in tranches per year through the Ministry of Finance and included in the budget to cover the government's fiscal deficit.

The CCPL has been designed to finance state budget deficit while at the same time can be used to finance climate change related policy reform on the basis of Climate Change National Action Plan. In the operational level, the CCPL has been implemented as per policy matrix agreed upon. The policy matrix is a medium to indicate the alignment of the loan with the national climate policy. Progress of implementation is monitored by a Steering Committee of CCPL. The Government of Indonesia and the Development Partners monitor and discuss the issue of CCPL in the "Joint Monitoring Meeting" held twice a year.

The CCPL policy matrix includes:

- Mitigation area covering land based sector, energy and transportation;
- Adaptation area covering climate forecasts, sensitivity impact assessment, water resource sector, agriculture sector, and marine and fisheries sector;
- Cross sectoral issues area including mainstreaming climate change in the national development program, financing scheme, and policy coordination for climate change and greenhouse gas emission reduction.

The Climate Change related loan in the period of 2005-2011 can be shown on the Table 2 and Table 3 below:

Table 2. Climate Change Related Loan (period of 2005-2011)

Financing Scheme	Amount				
	Activities	Fund			
		GBP	USD	EURO	JPY
Program Loan	7	-	1,000,000,000	-	85,819,000,000
Project Loan	4	-	300,000,000	9,000,000	26,966,000,000
Debt Swap	3	-	20,000,000	12,500,000	-
Grant	10	5,000,000	42,000,202	21,000,000	2,000,000

Source: Ministry of Finance of the Republic of Indonesia, 2012.

The CCPL from the period of 2005-2011 amounted to around Rp 1 billion and JPY 85,8 billion. Even though it has been designed to help the climate change programs in Indonesia, the problem is that there is no clear measurement to monitor and evaluate whether the loan goes to the climate change mitigation and adaptation action in Indonesia. The linking between this financial instrument and the mitigation impacts is not clearly visible. As Brown and Peskett (2011, p. 23) states, "The policy loan approach in the CCPL is seen as a helpful general budget support approach that can lower transaction costs, increase predictability of funding, and encourage more effective state and public administration but the disconnect between funding and climate change related policy outcomes means that it is unlikely to directly fund mitigation activities". Brown and Peskett (2011, p. 24) further states that "While it is possible to monitor the progress of policy actions agreed to through the CCPL policy matrix, it is impossible to monitor the money spent in relation to the actions, as no money is earmarked and none of the agencies working on the policies get an increase in resources to support those policies". Therefore although there is a policy matrix as a monitoring guideline, in the operational level it is very difficult to track whether the CCPL really goes to the climate change mitigation and adaptation program in Indonesia.

Table 3. The Climate Change Loan and Grant for Period of 2005-2011 (Donor based)

NO.	Country/Donor/Activity	AMOUNT
1	World Bank	USD 500,000,000
	- Climate Change Development Policy Loan (CC-DPL)	USD 200,000,000
	- Geothermal Clean Energy Investment Project	USD 300,000,000
2	AFD	USD 800,000,000
	- Climate Change Program Loan	USD 200,000,000
	- Climate Change Program Loan 2	USD 300,000,000
	- Climate Change Program Loan 3	USD 300,000,000
3	JICA	JPY 85,819,000,000
	- Climate Change Program Loan (INP-33)	JPY 30,768,000,000
	- Climate Change Program Loan (II) (INP-36)	JPY 28,083,000,000
	- Lumut Balai Geothermal Power Plant Project (IP-557)	JPY 26,966,000,000
	- The Forest Preservation Programme	JPY 1,000,000
	- The Programme for The Improvement of Capabilities to cope with Natural Disaster Caused by Climate Change	JPY 1,000,000
4	Kfw	EUR 42,500,000
	- Industrial Efficiency and Pollution Control Phase II	EUR 9,000,000
	- Debt Swap III for Nature-Strengthening the Development of National parks in the fragile ecosystem	EUR 6,250,000
	- Debt Swap III for Nature-Financial Assistance for Environmental Investment for Micro and Small Enterprises Project	EUR 6,250,000
	- German Financial Cooperation with Indonesia Forest Programme (support for Ministry of Forestry)	EUR 20,000,000
	- Industrial Efficiency and Pollution Control Phase II	EUR 1,000,000
5	USA	USD 20,000,000
	- Debt Nature Swap Tropical Forest Conservation ACT (DNS-TFCA)	USD 20,000,000
6	GEF (World Bank administered)	USD 4,000,000
	- Geothermal Power Generation Development Project	USD 4,000,000
7	UNDP	USD 460,000
	- Preparation Agreement for the Indonesia Climate Change Trust Fund (PREP-ICCTF)	USD 460,000
8	Norway (UNDP administered)	USD 31,585,952
	- Support to the Establishment of Indonesia REDD+ Infrastructure and Capacity	USD 31,585,952
9	FAO,UNDP,UNEP	USD 5,644,250
	- Indonesia UN-REDD National Joint Programme	USD 5,644,250
10	IDB	USD 310,000
	- Enhancement of Carbon sequestration through reforestation (IND-136)	USD 310,000
11	DFID	GBP 5,000,000
	- Arrangement on Cooperation to Support Forest Governance and Multi stakeholders Forestry Program	GBP 5,000,000

Source: the Ministry of Finance of the Republic of Indonesia, 2012.

4.4. The forgotten principle: Common but Differentiated Responsibility (CBDR)

In the context of global climate change debates, the concept of "common but differentiated responsibility" (CBDR) has been playing a significant role. It points to the facts that problems which are a common concern to mankind – such as climate change – affect all and are affected by all nations in differing degrees (www.climate.diplomacy.edu/page/cbdr-principle). Hence, the nations should bear different responsibilities to come up with solutions.

The article 3.1 of UNFCCC (1992, p. 4) states the principle of CBDR which stipulates that "Parties should protect the climate system for the benefit of future and present generations of human kind on the basis of equity and in accordance with their common but differentiated responsibility and respective capabilities. Accordingly, developed countries should take the lead in combating climate change and the adverse effect thereof". With regard to climate change, there are two considerations in the application of the CBDR principles: (1) the cumulative responsibility of countries for the problem (historical as well as current responsibility); (2) the ability of countries to deal with the problem in technical and economic term (www.climate.diplomacy.edu/page/cbdr-principle).

The Kyoto Protocol, which serves as the legally binding element to enforce the Convention, also covers the CBDR principle as found in article 10.1 of the Protocol. The article states that "All Parties taking into account their common but differentiated responsibilities and their specific national and regional development priorities, objectives, and circumstances....." The principle of CBDR implies that all nation-states have responsibility to tackle climate change problem but in different levels. The principle of CBDR has been formulated to differentiate between nations in the environmental issues. Given the fact that there must be common responsibility in protecting the environment, Mumma and Hodas (2008, p. 628) states that "It recognizes that there are global resources, such as the atmosphere, which human society has common interest in protecting, but which the obligation to protect will vary in accordance with a nation's level of development, resources, and institutional capabilities".

Further to the principle of CBDR is the Article 4.3 of the UNFCCC (1992, p. 5) which states that "The developed country Parties and other developed Parties included in Annex II shall provide new and additional financial resources to meet the agreed full costs incurred by developing country Parties.....". They shall also provide such financial resources, including for the transfer of technology, needed by the developing country Parties to meet the agreed full incremental costs.....". This article clearly demonstrates that the developed countries are responsible to assist the developing countries to cope with climate change problems. It then has been stressed by the Copenhagen Accord (2009, p. 3) which states in its agreement no. 8 that the developed countries will provide funding to the developing countries amounting to USD 30 billion for the period 2010-2012, and approximately USD 100 billion per year by 2020 to address the needs for developing countries. All these show the commitment from the developed countries to assist the developing countries with the financial flows to address the impacts of climate change.

The principle of CBDR and further steps aforementioned imply that the developed countries bear responsibilities to assist the developing countries in terms of financial aspect. As the parties which have caused the climate change problems, they have moral obligation to help developing countries to mitigate the

adverse impacts of climate change. However, the financial assistance could not be in the form of loan because it will add more burdensome to developing countries. The financial assistance should be in the form of grants as their compensation to developing countries in combating climate change and address the effects of climate change.

5. Conclusion

Indonesia has received the CCPL at the significant level in the budget system as a deficit gap financing. The CCPL has been designed to finance state budget deficit while at the same time can be used to finance climate change related policy reform on the basis of Climate Change National Action Plan. In the operational level, the CCPL has been implemented as per policy matrix agreed upon. However, measurement to monitor the effectiveness of the use of CCPL remains unclear. The developed countries are responsible to lead the global community to combat climate change. They should provide financial assistance to developing countries to mitigate the climate change adverse impacts. These financial assistances to developing countries are perceived as their compensation because the developed countries have caused the most climate change problems at the global level. Therefore, the assistance from developed countries should be in the form of grants. Any kinds of financial assistance from developed countries to developing countries are considered morally unfair. This paper suggests that Indonesia should stop the CCPL from developed countries and should not receive any kinds of climate change loans anymore.

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